

COUNTY REVOLVING LOAN FUND PROGRAM

(Approved August 15, 2003)



As adopted, HB 611 contemplated the potential use of Agricultural Development Funds to establish local revolving loan funds. A benefit of revolving loan funds is that funds will be available in the future to assist producers in additional expansions of their operations, even after the Tobacco Settlement funding has ceased to exist.

Specifically KRS 248.711(2) provides:

- ... (2) *Uses and restrictions on the funds in the counties account shall include, but not be limited to, the following*
- (a) *Funds may be used for deferred, no-interest, or low-interest venture capital loans to enhance farms' revenues by initiating:*
 - 1. *Current farming techniques or practices or improvements; or*
 - 2. *New farming ventures on the farm;*
 - (b) *Funds used for loans shall be administered through a duly licensed or chartered financial institution organized and regulated:*
 - 1. *Under the laws of this state in accordance with KRS Chapter 287; or*
 - 2. *Created by Congress and organized and regulated in accordance with provisions of federal law;*
 - (c) *Terms of the loans may include a limit on deferral of payment of interest or principal to five (5) years, and a limit on the interest rates. Repaid loans and interest shall be credited to the appropriate county's allocation within the counties account;...*

The following guidelines and recommendations have been developed to assist local County Councils seeking to establish local revolving loan funds through the use of County Agricultural Development Funds.

This document provides program goals, eligible loan activities, and implementation guidelines for agencies seeking to initiate a local loan program. Guidelines are considered to be suggested minimum standards by which a program is to be implemented.

Questions concerning these guidelines should be directed to the Governor's Office of Agricultural Policy at (502) 564-4627. County Councils may establish the programs themselves or allow a local agency to operate such a program. In the latter case, application for funds must be directed through the local County Ag Development Council(s).

I. Program Goals

The goals of the program are to:

- Improve net farm income through the development and expansion of new agricultural products and through the development of new ways of dealing with existing agricultural commodities;
- Impact a high number of producers affected by loss of income resulting from cuts in tobacco quota;
- Assist producers desiring to develop alternative agricultural enterprises or improve existing farm operations by leveraging funding from other sources, including Agricultural Development grant funds, with below-market cost loan funds; and
- Provide a sustainable source of below-market financing at the county level that will remain after the end of the Tobacco Settlement Phase I payments through the long-term development of a revolving loan program to benefit producers and value-added agricultural entrepreneurs.

II. Eligible Loan Activities

The statute is very broad regarding the types of loans that can be made, specifying only that:

Funds may be used for deferred, no-interest, or low-interest venture capital loans to enhance farms' revenues by initiating

1. *Current farming techniques or practices or improvements; or*
2. *New farming ventures on the farm;*

The entity establishing the local County Revolving Loan Fund will also determine the eligible activities to be allowed under the program, assuring that activities conform to the statutory requirements above.

Funds may be established with a broad range of eligible activities or they may be limited, so as to target certain needed investments within the local agricultural community. For example, one county council may feel strongly about the need for a heifer replacement program, while another county would want to see its funds used by farmers desiring to enter the agri-tourism arena.

Loan funds may be used to provide the 50% match requirement of other Agricultural Development Fund grant programs.

Operating capital loans are permissible when guarantied by a third party.

Maximum Loan Amount and Loan Collateral:

The local entity establishing the Revolving Loan Fund will also determine the maximum loan amount.

No loan will exceed 50% of a total project's costs. The remaining 50% of financing may be provided through the Agricultural Development Fund's grant program (e.g. local diversification program), from borrower equity, or by a local lender.

Loans will be secured with a first lien or first mortgage, with security coming from the collateral being financed with the loan. In those cases where the loan is being matched with funds from a local lender the loan may be in a proportionate co-first lien position with the local lender's loan.

Loans may not be secured in a subordinate security position to any other loan unless that security is being provided as secondary security for a loan already secured with a first-position lien or mortgage.

Maximum Loan Term:

Loan term may not exceed seven years.

Interest Rate:

The interest rate will be determined by the local entity effective on January 1 of each year. All loans originated during that one-calendar-year period will receive that rate of interest. The interest rate will be locked in for the term of the loan. If loans are renewed at their maturity date, the interest rate will be adjusted to reflect the interest rate in effect at the time of renewal.

Prior to December 1 of each year the local entity will determine the rate of interest effective the following January 1, for all loans originated in the next year. This information will be provided to KAFC and participating local financial institutions.

Financial institutions will be allowed to charge a reasonable servicing fee either to the borrower or netted against the interest rate being charged for the local Revolving Loan.

Funding of Loans by KY Agricultural Finance Corporation:

Once the local financial institution has made its decision to approve the Revolving Loan for the borrower the lender will send notice to both the local Program Administrator and KY Agricultural Finance Corporation (KAFC). Included in the KAFC information will be:

1. Amount of loan, including the portion being funded through the Revolving Loan Fund plus the lender's portion of the loan, if applicable;

2. Term of the loan;
3. Interest rate of the financial institution's portion of the loan;
4. Interest rate on the Revolving Loan Fund portion of the loan (KAFC will check to make sure rate matches the rate provided KAFC by Program Administrator);
5. Collateral for loan; and
6. Estimated date of loan closing.

KAFC will assure that a **Master Inter-Creditor Agreement** is in place with the lender, and that funds remain in the county's Revolving Loan Fund account to fully fund the loan. KAFC also will assure that the proposed loan meets both state and local guidelines.

Prior to closing the loan the local financial institution will assure that collateral is free from other encumbrances other than those permitted by program guidelines. The lender then will close the loan with the borrower and record appropriate security instruments. The lender electronically or by facsimile will provide KAFC the documentation required in the Master Inter-Creditor Agreement to confirm the interest rate being charged and the collateral being provided for the loan. Upon receipt of this information KAFC will wire transfer funds to the lender.

III. Application Procedure

A. Guidelines for Local Agency Application for Program Administration

A County Council or a local agency may elect to establish a County Revolving Loan Fund and serve as the local administrator of the Fund. In either case the applicant will submit a request to the Agricultural Development Board which will include the following information:

1. The **Cover Sheet** of the Agricultural Development Board's application package;
2. Copy of **local guidelines** that will be distributed to local producers wishing to apply for a loan:
 - a. The amount of County Funds requested to establish the revolving loan fund;
 - b. Eligible activities for which funds may be lent;
 - c. The rate of interest being charged during the first year of the Revolving Loan Fund; and
 - d. Collateral requirements of borrowers in the Revolving Loan Fund;
3. **Letters** from local financial institutions wishing to serve as loan originators;
4. **Designation** of the local Program Administrator with a statement from that individual indicating willingness to serve as local administrator;
5. **Priority sheet** from the County Council indicating a High Priority for the program

B. Agricultural Development Board's & KY Agricultural Finance Corporation's Role

1. After assuring the proposed County Revolving Loan Fund meets program guidelines and that sufficient funds remain in the County's account, the Agricultural Development Board will approve the application;
2. The Agricultural Development Board will establish a cooperating agreement with the Kentucky Agricultural Finance Corporation by which KAFC will oversee and monitor the local county revolving loan funds. Upon approval of each local loan fund application the Agricultural Development Board will instruct KAFC to establish a unique account in the name of the specific county loan fund;
3. KAFC will establish the county loan fund account and will notify the local Program Administrator and participating local financial institutions of the availability of the funds;
4. KAFC will provide each local financial institution a Master Inter-Creditor Agreement setting forth the terms by which KAFC will provide funds to the lender for loans originated under the County Loan Fund program;

5. As local financial institutions originate loans KAFC will wire funds. KAFC also will receive payments from local lenders as the loans are repaid by local borrowers; and
6. Principal and interest payments from loan borrowers will return to each local county account to be available for future eligible loan activities within the county. KAFC will provide to the local Program Administrator and local financial institutions a monthly report showing fund balances.

C. Guidelines for Local Producer Application Process

1. Individuals seeking to borrow funds from the County Revolving Loan Fund will submit the **locally prepared application** form to the local Program Administrator indicating the activities for which financing is being requested as well as the amount of funds being sought from the Loan Fund;
2. The Program Administrator will **date stamp** the application and **review** the application to assure that proposed activities meet local eligible activity requirements and that monies are available to fund the loan;
3. If borrower's application meets local guidelines and if funds are available for the loan, then the Program Administrator will issue a **certificate** to the borrower to take to the local financial institution. The certificate will indicate that funds have been set aside in the name of the borrower for the loan, assuming the bank is willing to make the loan to the borrower. The certificate also will indicate the interest rate currently in effect for loans from the Revolving Loan Fund. The Program Administrator will attach a copy of the borrower's application to the certificate;
4. The borrower will take the certificate to the financial institution that then will make a credit decision to originate the loan to the borrower. The lender notifies the Program Administrator of its decision;
5. In the event of a negative decision by the lender, the Program Administrator removes the set-aside for that borrower, in order to make funds available to other borrowers; and
6. In the event of a positive decision, the lender also notifies KAFC of its decision and moves forward to close the loan with borrower. Upon loan closing KAFC wires funds to lender.

D. Borrower Requirements

1. The program shall be open to all county/regional producers, as determined by the applicant counties and cannot be tied to participation in any organization. Tobacco dependency of the prospective borrower may be a criterion for participation in the revolving loan program;

2. The application submitted to the Program Administrator must be signed and dated by the producer and must include a date/time stamp from the administrative body as well as the initials of person logging in the application. Postmarks or dated letters of application will not override the stamp applied by the Program Administrator;
3. Applications will be taken on a first come first serve basis;
4. An application from an individual **without** a tax ID or social security number will be considered **incomplete**;
5. Each borrower will be expected to meet all requirements imposed by the financial institution's loan documents. Failure to comply with those provisions may result in an event of default and require immediate repayment of loan funds to the financial institution and to the revolving loan fund.

IV. Guidelines for Local Program Administrator

Unlike administration of a grant program, where funds are disbursed in a relatively short time period at which the grant program ceases, a revolving loan fund by its nature will be ongoing. It is imperative that an agency be in existence that can assure the funds are being used as intended and equally important, are being repaid under the terms by which they were lent. To assure continuity of the local program the **Kentucky Agricultural Finance Corporation (KAFC)** will serve as the clearinghouse for the funds set aside for each county's revolving loan fund. As noted above, KAFC will establish a loan fund for each participating county and will track and account for funds, segregating proceeds, so as not to commingle one county's funds with another.

Each local Revolving Loan Fund will be designed at the local level by an administering agency or the County Council. The parameters for loan activities and priorities will be a local decision so long as they conform to the minimum guidelines set out in this document. Applications for loan funds will be made available at the office of the local Program Administrator, also designated by the administering agency or the County Council.

Unlike other county level programs approved by the Agricultural Development Board, there will not be a grant agreement between the local agency and the Agricultural Development Board (Board). Rather, the Board will enter into an agreement with KAFC to administer the funds for the benefit of the local county program. KAFC in turn will enter into agreements with the local financial institutions originating the loans. The financial institutions will enter into agreements with program borrowers, just as they would for any of their regular loan programs. The exception, however will be that the loan documents will reflect the benefits that result from the local revolving loan fund (for example, a below market interest rate).

V. Guidelines for Local Financial Institutions

KRS 248.711(2)(b) provides:

Funds used for loans shall be administered through a duly licensed or chartered financial institution organized and regulated:

- 2. Under the laws of this state in accordance with KRS Chapter 287; or*
- 3. Created by Congress and organized and regulated in accordance with provisions of federal law;*

Under these Guidelines, each loan applicant will present the certificate issued by the local Program Administrator to his or her own local bank. The bank, not the County Council or the Program Administrator, will make the credit decision for the portion of the loan being funded from the Revolving Loan Fund along with other funds being provided by the bank for the same project. By following this type of process, no one other than the lender is involved in the credit decision, thus helping to protect the borrower's privacy. Any financial institution in the community meeting the statutory requirements indicated above can participate in the program allowing the borrower to choose the lender. Each financial institution participating in the local revolving loan fund will enter into a Master Inter-Creditor Agreement with KAFC. The Agreement will specify at a minimum the following:

1. That the local bank is responsible for making the credit decision and assuring that the loan is adequately collateralized;
2. That the local financial institution is responsible for servicing the loan and collecting in the event of a default by the borrower;
3. The servicing fee the bank will charge for administering each Revolving Loan;
4. The procedure for obtaining funds from the County's Account at KAFC. For example the local lender may prefer to issue a certificate of deposit in favor of the local revolving loan fund with the rate of interest being paid on the CD (net of servicing fees) equal to the rate of interest being charged by the local Revolving Loan Fund;
5. The procedure for remitting repaid loan funds back to the County's Account maintained by KAFC;
6. Procedure to be followed in the event of loan defaults including payment of proceeds obtained through liquidation of assets.

KAFC accounts for all loans in the local program so that outstanding fund balances are readily known and immediately available for the borrower upon approval by the lender.